

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA

LOCKHART POWER COMPANY

Docket No. 2007-33-E

Settlement Testimony

of

Paul R. Moul, Managing Consultant
P. Moul & Associates

Concerning

Rate of Return

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SETTLEMENT TESTIMONY OF PAUL R. MOUL

1 **Q. Please state your name, business address, and occupation.**

2 A. My name is Paul Ronald Moul. My business address is 251 Hopkins Road, Haddonfield,
3 NJ 08033-3062. I am Managing Consultant of the firm P. Moul & Associates, an
4 independent, financial, and regulatory consulting firm. My educational background,
5 business experience, and qualifications are provided in Appendix A that follows my direct
6 testimony. I have submitted rate of return testimony in numerous cases for the Company
7 over the past twenty-three years.

8 **Q. What is the purpose of your testimony?**

9 A. My testimony supports the settlement agreement dated May 18, 2007 among Lockhart
10 Power Company ("Lockhart" or the "Company"), the South Carolina Office of Regulatory
11 Staff ("ORS"), and the South Carolina Energy User's Committee ("SCEUC"). In that
12 settlement agreement, all parties have agreed to resolve this case using a 12.00% return on
13 equity, as one component of the Company's revenue requirements.

14 **Q. Based upon your analysis, do you believe that the 12.00% rate of return on common**
15 **equity contained in the settlement agreement is reasonable?**

16 A. Yes. I believe that 12.00% represents a reasonable rate of return on common equity for
17 Lockhart. My conclusion is based upon the Company's risk factors, as well as a variety of
18 methods usually considered in measuring the cost of equity in proceedings such as these.
19 By considering a variety of approaches, I believe that a reasonable rate of return on
20 common equity is 12.00%.

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1 **Q. What risk factors indicated to you that a 12.00% rate of return on common equity is**
2 **reasonable for the Company?**

3 A. Lockhart is a very small electric utility. In the year 2005, the Company had just 6,310
4 customers and had only 39 employees. The Company has realized a net gain of only 113
5 customers since 2001, including the loss of one industrial customer. I know of no other
6 investor-owned electric utility that is this small. In 2005, the Company generated
7 approximately 23% of its energy from a run-of-the-river hydroelectric facility and
8 purchased 77% of its electric requirements from Duke Energy. Also, in 2005, the
9 Company's direct sales (excluding sales for resale) were represented by approximately
10 33% to residential, 9% to commercial, and 58% to industrial customers. While
11 representing 58% of direct electric sales, there are only ten (10) industrial customers. This
12 means that the energy needs of a few customers have a significant impact on the
13 Company's operations. The Company also has one sale for resale customer that represents
14 approximately 40% of total megawatt hour sales. In the aggregate, the ten industrial
15 customers and one wholesale customer represent 74% of total megawatt hour
16 requirements.

17 **Q. How do these factors affect the Company's risk?**

18 A. Its risk profile is strongly influenced by electricity sold to industrial customers and sales
19 for resale. Sales to industrial and sales for resale customers, represent approximately 74%
20 of total sales by the Company. In the industrial class of customers, the Company's
21 business profile is dominated by textile and textile related industries. Sales to high volume
22 customers are usually thought to be of higher risk than sales to other classes of customers.

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1 Success in this segment of the Company's market is subject to (i) the business cycle, (ii)
2 the price of alternative energy sources, and (iii) pressures from alternative providers. In
3 the textile industry, foreign competition has dimmed the outlook for this industry.
4 Moreover, external factors can also influence the Company's sales to these customers
5 which face competitive pressures on their own operations from other facilities outside the
6 Company's service territory. The risk associated with serving industrial customers
7 engaged in the textile and textile related industries can also have a ripple effect on other
8 classes of customers. That is to say, sales to residential and commercial customers can
9 also be impacted by plant closures that may occur.

10 **Q. Does its construction program also affect the Company's risk?**

11 A. Lockhart is faced with the requirement to undertake investment to maintain and upgrade
12 existing facilities in its service territory and to maintain system reliability. Over the 2006-
13 2010 period, Lockhart's capital expenditures are expected to represent approximately 50%
14 of its net utility plant. In order to fund these substantial capital expenditures, the
15 Company's parent (Milliken & Company, Inc.) has elected to forego any dividends in the
16 year 2006, and potentially beyond.

17 **Q. Please summarize your risk assessment of Lockhart?**

18 A. Lockhart's business risk profile is dominated by:

- 19 • Its very small size.
- 20 • Low growth in its service territory
- 21 • Limited diversity in its service territory
- 22 • A service area whose economy is highly dependent upon the
- 23 textile and textile related industries.
- 24 • Heavy reliance upon purchased power to meet the energy
- 25 requirements of its customers.
- 26 • Its large capital expenditures.

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1 Significantly, Lockhart is several orders of magnitude smaller than the average size of the
2 electric companies that I considered in reaching my conclusion. The proxy group that I
3 considered consists of eight publicly-traded companies that are included in The Value Line
4 Investment Survey, whose electric utility subsidiaries operate in the southeastern region of
5 the U.S., and are not currently the target of a merger or acquisition. The Company
6 possesses higher operating risk than the electric proxy group. The Company's retail
7 customer base is dominated by a large proportion of sales to few industrial customers,
8 many of which are engaged in textile manufacturing and related industries. The
9 Company's capital expenditures are also expected to be relatively large in the future.
10 Overall, Lockhart's unique risk traits indicate that the Company has more risk than the
11 electric proxy group.

12 **Q. Please summarize your assessment of the 12.00% rate of return on common equity**
13 **contained in the settlement agreement.**

14 A. Given the Company's risk traits, its 100% common equity ratio, and its extremely small
15 size, a 12.00% rate of return on common equity is reasonable for Lockhart. This rate of
16 return on common equity is consistent with well-recognized principles for determining a
17 fair rate of return. The rate of return established in a rate case must provide the Company
18 with an opportunity to cover dividend payments, provide a reasonable level of earnings
19 retention, produce an adequate level of internally generated funds to meet capital
20 requirements, and be commensurate with the risk to which the Company's capital is
21 exposed. The 12.00% return on equity contained in the settlement agreement fulfills these
22 requirements. In the aggregate, the models that I consider, which include: the Discounted

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1 Cash Flow ("DCF") model, the Risk Premium analysis, the Capital Asset Pricing Model
2 ("CAPM"), and the Comparable Earnings approach, also indicates that the rate of return
3 on common equity of 12.00% is reasonable for the Company, when considering the
4 market and financial data for the electric proxy group. Based upon the consideration of a
5 variety of factors, it is my opinion that the 12.00% return on equity is reasonable in order
6 to accommodate the unique risk characteristics of Lockhart.

7 **Q. Does this conclude your prepared settlement testimony?**

8 A. Yes.

APPENDIX A TO DIRECT TESTIMONY OF PAUL R. MOUL

**EDUCATIONAL BACKGROUND, BUSINESS EXPERIENCE
AND QUALIFICATIONS**

I was awarded a degree of Bachelor of Science in Business Administration by Drexel University in 1971. While at Drexel, I participated in the Cooperative Education Program which included employment, for one year, with American Water Works Service Company, Inc., as an internal auditor, where I was involved in the audits of several operating water companies of the American Water Works System and participated in the preparation of annual reports to regulatory agencies and assisted in other general accounting matters.

Upon graduation from Drexel University, I was employed by American Water Works Service Company, Inc., in the Eastern Regional Treasury Department where my duties included preparation of rate case exhibits for submission to regulatory agencies, as well as responsibility for various treasury functions of the thirteen New England operating subsidiaries.

In 1973, I joined the Municipal Financial Services Department of Betz Environmental Engineers, a consulting engineering firm, where I specialized in financial studies for municipal water and wastewater systems.

In 1974, I joined Associated Utility Services, Inc., now known as AUS Consultants. I held various positions with the Utility Services Group of AUS Consultants, concluding my employment there as a Senior Vice President.

In 1994, I formed P. Moul & Associates, an independent financial and regulatory consulting firm. In my capacity as Managing Consultant and for the past twenty-nine years, I have continuously studied the rate of return requirements for cost of service regulated firms. In this regard, I have supervised the preparation of rate of return studies which were employed in connection with my testimony and in the past for other individuals. I have presented direct

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1 testimony on the subject of fair rate of return, evaluated rate of return testimony of other
2 witnesses, and presented rebuttal testimony.

3 My studies and prepared direct testimony have been presented before thirty (30) federal,
4 state and municipal regulatory commissions, consisting of: the Federal Energy Regulatory
5 Commission; state public utility commissions in Alabama, Connecticut, Delaware, Florida,
6 Georgia, Hawaii, Illinois, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan,
7 Minnesota, Missouri, New Hampshire, New Jersey, New York, North Carolina, Oklahoma,
8 Ohio, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and West Virginia; and the
9 Philadelphia Gas Commission. My testimony has been offered in over 200 rate cases involving
10 electric power, natural gas distribution and transmission, resource recovery, solid waste
11 collection and disposal, telephone, wastewater, and water service utility companies. While my
12 testimony has involved principally fair rate of return and financial matters, I have also testified
13 on capital allocations, capital recovery, cash working capital, income taxes, factoring of
14 accounts receivable, and take-or-pay expense recovery. My testimony has been offered on
15 behalf of municipal and investor-owned public utilities and for the staff of a regulatory
16 commission. I have also testified at an Executive Session of the State of New Jersey
17 Commission of Investigation concerning the BPU regulation of solid waste collection and
18 disposal.

19 I was a co-author of a verified statement submitted to the Interstate Commerce
20 Commission concerning the 1983 Railroad Cost of Capital (Ex Parte No. 452). I was also co-
21 author of comments submitted to the Federal Energy Regulatory Commission regarding the
22 Generic Determination of Rate of Return on Common Equity for Public Utilities in 1985, 1986,
23 and 1987 (Docket Nos. RM85-19-000, RM86-12-000, RM87-35-000, and RM88-25-000).

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1 Further, I have been the consultant to the New York Chapter of the National Association of
2 Water Companies which represented the water utility group in the Proceeding on Motion of the
3 Commission to Consider Financial Regulatory Policies for New York Utilities (Case 91-M-
4 0509). I have also submitted comments to the Federal Energy Regulatory Commission in its
5 Notice of Proposed Rulemaking (Docket No. RM99-2-000) concerning Regional Transmission
6 Organizations and on behalf of the Edison Electric Institute in its intervention in the case of
7 Southern California Edison Company (Docket No. ER97-2355-000).

8 In late 1978, I arranged for the private placement of bonds on behalf of an investor-
9 owned public utility. I have assisted in the preparation of a report to the Delaware Public
10 Service Commission relative to the operations of the Lincoln and Ellendale Electric Company. I
11 was also engaged by the Delaware P.S.C. to review and report on the proposed financing and
12 disposition of certain assets of Sussex Shores Water Company (P.S.C. Docket Nos. 24-79 and
13 47-79). I was a co-author of a Report on Proposed Mandatory Solid Waste Collection
14 Ordinance prepared for the Board of County Commissioners of Collier County, Florida.

15 I have been a consultant to the Bucks County Water and Sewer Authority concerning
16 rates and charges for wholesale contract service with the City of Philadelphia. My municipal
17 consulting experience also included an assignment for Baltimore County, Maryland, regarding
18 the City/County Water Agreement for Metropolitan District customers (Circuit Court for
19 Baltimore County in Case 34/153/87-CSP-2636).

20 I am a member of the Society of Utility and Regulatory Financial Analysis (formerly the
21 National Society of Rate of Return Analysts) and have attended several Financial Forums
22 sponsored by the Society. I attended the first National Regulatory Conference at the Marshall-
23 Wythe School of Law, College of William and Mary. I also attended an Executive Seminar

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sponsored by the Colgate Darden Graduate Business School of the University of Virginia concerning Regulated Utility Cost of Equity and the Capital Asset Pricing Model. In October 1984, I attended a Standard & Poor's Seminar on the Approach to Municipal Utility Ratings, and in May 1985, I attended an S&P Seminar on Telecommunications Ratings.

My lecture and speaking engagements include:

<u>Date</u>	<u>Occasion</u>	<u>Sponsor</u>
April 2006	Thirty-eighth Financial Forum	Society of Utility & Regulatory Financial Analysts
April 2001	Thirty-third Financial Forum	Society of Utility & Regulatory Financial Analysts
December 2000	Pennsylvania Public Utility Law Conference: Non-traditional Players in the Water Industry	Pennsylvania Bar Institute
July 2000	EEI Member Workshop Developing Incentives Rates: Application and Problems	Edison Electric Institute
February 2000	The Sixth Annual FERC Briefing	Exnet and Bruder, Gentile & Marcoux, LLP
March 1994	Seventh Annual Proceeding	Electric Utility Business Environment Conf.
May 1993	Financial School	New England Gas Assoc.
April 1993	Twenty-Fifth Financial Forum	National Society of Rate of Return Analysts
June 1992	Rate and Charges Subcommittee Annual Conference	American Water Works Association
May 1992	Rates School	New England Gas Assoc.
October 1989	Seventeenth Annual Eastern Utility Rate Seminar	Water Committee of the National Association of Regulatory Utility Commissioners Florida Public Service Commission and University of Utah
October 1988	Sixteenth Annual Eastern Utility Rate Seminar	Water Committee of the National Association of Regulatory Utility Commissioners, Florida Public Service

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1			Commission and University
2			of Utah
3	May 1988	Twentieth Financial	National Society of
4		Forum	Rate of Return Analysts
5	October 1987	Fifteenth Annual	Water Committee of the
6		Eastern Utility	National Association
7		Rate Seminar	of Regulatory Utility
8			Commissioners, Florida
9			Public Service Commis-
10			sion and University of
11			Utah
12	September 1987	Rate Committee	American Gas Association
13		Meeting	
14	May 1987	Pennsylvania	National Association of
15		Chapter	Water Companies
16		annual meeting	
17	October 1986	Eighteenth	National Society of Rate
18		Financial	of Return
19		Forum	
20	October 1984	Fifth National	American Bar Association
21		on Utility	
22		Ratemaking	
23		Fundamentals	
24	March 1984	Management Seminar	New York State Telephone
25			Association
26	February 1983	The Cost of Capital	Temple University, School
27		Seminar	of Business Admin.
28	May 1982	A Seminar on	New Mexico State
29		Regulation	University, Center for
30		and The Cost of	Business Research
31		Capital	and Services
32	October 1979	Economics of	Brown University
33		Regulation	

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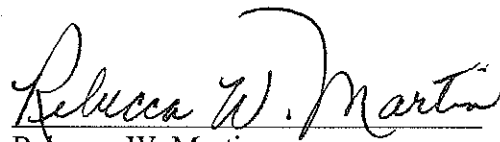
Re: Application of Lockhart Power Company)
for a Rate Increase)
_____)

**CERTIFICATE
OF SERVICE**

This is to certify that I, Rebecca W. Martin, an employee with the McNair Law Firm, P. A., have this date served one (1) copy of the attached Settlement Testimony of Paul R. Moul in the above-referenced matter to the persons named below by causing said copies to be deposited with the United States Postal Service, first class postage prepaid and affixed thereto, and addressed as shown below.

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May 23 2007

Columbia, SC